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In the

Supreme Court of the United States.

October Term, 1933.

No. [redacted] 12

Guy T. Helvering, Commissioner of Internal Revenue,
Petitioner,

v.

Morgan's, Incorporated, et al.

RESPONDENTS' BRIEF IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI.

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In the

Supreme Court of the United States.

OCTOBER TERM, 1933.

No. 904.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, *Petitioner*,

v.

MORGAN'S, INCORPORATED, ET AL.

RESPONDENTS' BRIEF IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI.

The Solicitor General, on behalf of Guy T. Helvering, Commissioner of Internal Revenue, seeks a writ of certiorari to review the judgment of the Circuit Court of Appeals for the First Circuit entered in the above-entitled case on December 15, 1933 (R. 33-40). This opinion is reported in 68 F. (2d) 325.

QUESTION PRESENTED.

Where two pre-existing corporations, each keeping its accounts and making its income tax returns for calendar years, become affiliated during a calendar year, and thereafter a consolidated return is filed, including the income of the parent for the whole calendar year and of the subsidiary from the date of affiliation to the end of the calendar

year, and the subsidiary files a separate return for the portion of the calendar year from January 1 to the date of affiliation, has that subsidiary during that calendar year filed returns for two taxable years or one taxable year for the purpose of applying the net loss provisions of section 206 of the Revenue Act of 1926?

Statement of Facts.

Morgan's, Incorporated, the parent, on June 1, 1925, acquired the entire capital stock of Haines Furniture Company, the subsidiary, and the two companies, both Massachusetts corporations maintaining books on a calendar year basis, were affiliated from then to the end of 1927. (The two corporations are still affiliated.)

Haines Furniture Company filed a separate return for the period January 1, 1925, to May 31, 1925, disclosing its net loss of $59,239.56; its net loss for the balance of the calendar year 1925 of $61,626.69 was included in the consolidated corporation income tax return filed by Haines Furniture Company and Morgan's, Incorporated, for the calendar year 1925. For 1926 the net loss of $2551.76 of Haines Furniture Company was included in the consolidated corporation income tax return filed by Haines Furniture Company and Morgan's, Incorporated. In the consolidated corporation income tax return filed by the same companies for the calendar year 1927, the income of Haines Furniture Company of $63,188.34 was reduced by the net loss sustained by that company for the period January 1, 1925, to May 31, 1925, of $59,239.56. The Commissioner refused to allow this deduction and assessed a deficiency against each company. No part of the net loss sustained by Haines Furniture Company for the fractional part of the year 1925 prior to affiliation with Morgan's, Incorporated, had been allowed in computing the consolidated net income for the

taxable period June 1, 1925, to December 31, 1925, or for the calendar years 1926 and 1927. The deficiency assessed against each petitioner for the year 1927 represents the allocation to each of the deficiency claimed to be due on the basis of net income properly assignable to each corporation as provided in the Revenue Act of 1926, section 240 (b).

Statutes and Regulations Involved.

The statutes and regulations involved are set forth in Appendix A, pages 9 to 18.

Reasons for Denying the Writ.

1. The decision below is in accord with the decision in *Arnold Constable Corporation* v. *Commissioner of Internal Revenue,* decided by the Circuit Court of Appeals for the Second Circuit on March 12, 1934. The opinion in that case is not yet reported, but a copy is printed as Appendix B (pages 18 to 23). There is also pending in the Circuit Court of Appeals for the Sixth Circuit the case of *Joseph & Feiss Co.* v. *Commissioner,* in which the issue is the same as in the present case. We are informed that the Government has suggested that the Circuit Court might deem it advisable to delay its decision in that case until after the action of the Court upon this writ.

Other than these cases, we know of no case pending in any circuit involving the issue in this case.

The decision in this case is not in conflict with the decision of the Court of Appeals of the District of Columbia in *Wishnick-Tumpeer, Inc.,* v. *Commissioner,* decided March 12, 1934.

This case may be readily distinguished from the case of *Wishnick-Tumpeer, Inc.*

In the case of *Wishnick-Tumpeer, Inc.*, the parent and subsidiary corporations had different accounting periods. The taxable year of the subsidiary ended October 31 and of the parent December 31.

The question involved in the *Wishnick-Tumpeer* case was a question involved in a return for the year 1929 to which Regulations 75 applied. Article 14 of Regulations 75 reads as follows:

> "Accounting period of an affiliated group.—The taxable year of the parent corporation shall be considered as the taxable year of an affiliated group which makes a consolidated return, and the consolidated net income must be computed on the basis of the taxable year of the parent corporation."

On January 1, 1929, the parent asked for and received permission to change its accounting period from the calendar year to a fiscal year ending June 30. The parent had filed a separate return for the calendar year 1928, and the subsidiary had filed a separate return for its fiscal year ending October 31, 1928. When the parent changed its taxable year from the calendar year to a fiscal year ending June 30, the parent's taxable year 1929 became, under section 47 (a) of the Revenue Act of 1928, the period from January 1 to June 30, 1929.

When, therefore, a consolidated return was filed by the parent and subsidiary for 1929, the subsidiary automatically changed from one fiscal year to another; and the period consisting of November and December, 1928, was after one taxable year of the subsidiary ended, and before the next taxable year of the parent, and consequently of the subsidiary, began. When this happened the period consisting of November and December, 1928, was squeezed out as a separate accounting period, and, under the provisions of

sections 47 (a), (b) and (c) of the Revenue Act of 1928, must be treated as a separate accounting and taxable period for which a separate return had to be filed "for a fractional part of a year." (See also Regulations 74, article 371.)

Such a period was within the express words of section 117 (b) of the Revenue Act of 1928 defining the words "taxable year." The sentence relevant (which is also included under section 200 (a) of the Revenue Act of 1926) reads as follows:

> "The term 'taxable year' includes, in the case of a return made *for a fractional part of the year* under the provisions of this title or under regulations prescribed by the Commissioner with the approval of the Secretary, the period for which such return is made." (Italics supplied.)

Furthermore, under the provisions of article 41 (d) of Regulations 75, the return for the period November and December, 1928, was for a "taxable year." Section 41 (d) reads as follows:

> "Taxable year.—Any period of less than twelve months for which either a separate return or a consolidated return is filed, under the provisions of article 13, shall be considered as a taxable year."

By sections 141 (a) and (b) of the Revenue Act of 1928, each corporation in the affiliated group making the consolidated return consents to the regulations made by the Commissioner and the Commissioner is given the power to make regulations relative to the filing of consolidated returns.

It would seem, therefore, that in the *Wishnick-Tumpeer* case the return of the subsidiary for the period consisting of November and December, 1928, is a return for a taxable year; first, because the regulations of the Commissioner so

say, and secondly, because it is a return for a separate accounting period that is squeezed out when a taxpayer changes its taxable year.

The situation is entirely different in the present case. Section 240 (a) of the Revenue Act of 1926 provides that affiliated corporations may make consolidated returns under regulations prescribed by the Commissioner with the approval of the Secretary.

The Commissioner then prescribed by Regulations 69, article 634. Under these Regulations he did not prescribe that a return made for the first portion of the taxable year of a subsidiary prior to affiliation should be a return for a taxable year as he did in article 41 (d) of Regulations 75, or in fact that the return for such period should be a return "for a fractional part of a year" in the sense that the last-quoted phrase is used in the Statute and Regulations. As appears from articles 431, 625 and 651 of Regulations 69, a return "for a fractional part of a year" refers to a return for a separate accounting period where that accounting period is less than twelve months. But in the situation presented in the present case there was no change of accounting period. Both parent and subsidiary always used the calendar year as their respective accounting periods. In such a situation article 634 of Regulations 69 evidently does not regard the separate return which it requires a subsidiary to file (in this case the Haines Furniture Company for the period January 1 to May 31, 1925) as a return "for a fractional part of a year," and hence for "a taxable year." The regulation expressly states that this is a return "for that part of the taxable year" and "for the portion of the taxable year during which they were not affiliated"; and, contrary to returns "for a fractional part of a year," this return is not due "until the fifteenth day of the third month following the close of the taxable year." This separate return is expressly a return for a portion of a taxable year.

We do not see how it can be said with any consistency, therefore, to be a return for a whole taxable year or "for a fractional part of a year," which is said by the Statute to be a taxable year. In the *Wishnick-Tumpeer* case, on the other hand, the separate return for November and December, 1928, is by law a return for a separate accounting period and "for a fractional part of a year." It comes, therefore, within the express words of the Statute. It also comes within the express words of the Regulations applicable in 1929 defining the taxable year.

But under the Statute and Regulations applicable to the case at bar there is nothing which expressly requires the separate return filed by Haines Furniture Company for the period from January 1 to May 31, 1925, to be considered as a return for a whole taxable year.

2. The decision below is correct.

Unless the express words of the Statute require, and permit of no other construction, there is no reason why the Haines Furniture Company should be entitled to use past losses for one year and seven months only as deductions from income, when other corporations may use losses for two years, especially when the only purpose of the sentence in section 200 (a) of the Revenue Act of 1926, quoted on page 5 of this brief, was to broaden the scope of the deduction rather than to restrict it.

When this sentence was first being considered in connection with the Revenue Act of 1924, the Ways and Means Committee made the following statement referring to this sentence:

> "In subdivision (a) of this Section the term 'taxable year' is defined to include a period of less than a year when a return is made for such period. Under the existing law the use of the term 'taxable year' in the

'net loss' section and other sections has been construed not to cover the case of a return made by a taxpayer for a fractional part of a year, with the result that the benefits of such sections are denied the taxpayers who are required by law to make a return for a fractional part of a year."

This was brought out clearly by the dissenting opinion of Member Van Fossan, in the case of *Weissberger Moving & Storage Company, Inc.*, v. *Commissioner*, 26 B.T.A. 1375, 1377; and in the decision in the case of *Arnold Constable Corporation* v. *Commissioner of Internal Revenue*, Appendix B, pages 21 and 22.

Wherefore it is respectfully submitted that the petition should be denied.

April, 1934.

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Appendix A.

Material Portions of Statutes and Regulations Involved.

Revenue Act of 1926, C. 27, 44 Stat. 9.

Section 200.

(a) The term "taxable year" means the calendar year, or the fiscal year ending during such calendar year, upon the basis of which the net income is computed under section 212 or 232. The term "fiscal year" means an accounting period of twelve months ending on the last day of any month other than December. The term "taxable year" includes, in the case of a return made for a fractional part of a year under the provisions of this title or under regulations prescribed by the Commissioner with the approval of the Secretary, the period for which such return is made. The first taxable year, to be called the taxable year 1925, shall be the calendar year 1925 or any fiscal year ending during the calendar year 1925. (26 U.S.C.A. section 931 (a).)

Section 206.

(b) If, for any taxable year, it appears upon the production of evidence satisfactory to the Commissioner that any taxpayer has sustained a net loss, the amount thereof shall be allowed as a deduction in computing the net income of the taxpayer for the succeeding taxable year (hereinafter in this section called "second year"), and if such net loss is in excess of such net income (computed without such deduction), the amount of such excess shall be allowed as a deduction in computing the net income for the next succeeding taxable year (hereinafter in this section called "third year"); the deduction in all cases to be made under regulations prescribed by the Commissioner with the approval of the Secretary. (26 U.S.C.A. section 937 (b).)

Section 240.

(a) Corporations which are affiliated within the meaning of this section may, for any taxable year, make separate returns or, under regulations prescribed by the Commissioner with the approval of the Secretary, make a consolidated return of net income for the purpose of this title, in which case the taxes thereunder shall be computed and determined upon the basis of such return. If return is made on either of such bases, all returns thereafter made shall be upon the same basis unless permission to change the basis is granted by the Commissioner. (26 U.S.C.A. section 993 (a).)

Section 240.

(b) In any case in which a tax is assessed upon the basis of a consolidated return, the total tax shall be computed in the first instance as a unit and shall then be assessed upon the respective affiliated corporations in such proportions as may be agreed upon among them, or, in the absence of any such agreement, then on the basis of the net income properly assignable to each. There shall be allowed in computing the income tax only one specific credit computed as provided in subdivision (b) of section 236. (26 U.S.C.A. section 993 (b).)

TREASURY REGULATIONS 69, PROMULGATED UNDER THE REVENUE ACT OF 1926.

Article 431.

Returns for periods of less than 12 months. No return can be made for a period of more than 12 months. A separate return for a fractional part of a year is therefore required wherever there is a change, with the approval of the Commissioner, in the basis of computing net income from one taxable year to another taxable year. The periods

to be covered by such separate returns in the several cases are stated in the statute. The requirements with respect to the filing of a separate return and the payment of tax for a part of a year are the same as for the filing of a return and the payment of tax for a full taxable year closing at the same time. (See sections 227 and 270 and articles 441-447 and 1201.) The tax on net income computed on the basis of the period for which a separate return is made shall be paid thereon at the rate for the calendar year in which such period is included. In case of a change in the accounting period the net income computed on the return for the fractional part of a year shall be placed on an annual basis and the tax computed as provided in section 226 (c). See further section 212 and articles 25 and 26, and as to corporations, sections 232 and 239 and articles 531 and 625.

Since it is not required that income be placed on an annual basis except where the taxpayer voluntarily changes his accounting period, the income of a decedent or of his estate for the fractional parts of the year in which he died need not be placed on an annual basis.

Article 625.

Returns for fractional part of year. If a corporation, with the approval of the Commissioner, changes its accounting period from calendar year to fiscal year, from fiscal year to calendar year, or from one fiscal year to another fiscal year, a separate return shall be made for a fractional part of a year and the net income on such return shall be placed on an annual basis as provided in section 226 (c). (See article 431.) In all other cases the credit of $2,000 against net income allowed a domestic corporation having a net income not exceeding $25,000 shall be reduced to such proportion of the full credit as the number of months in the period for which the return is made bears to 12 months.

Article 634.

Change in ownership during taxable year. (a) Where corporations are affiliated at the beginning of a taxable year but due to a change in stock ownership during the year the affiliated status is terminated, or (b) where corporations are not affiliated at the beginning of the taxable year but through change of stock ownership during the year become affiliated, a full disclosure of the circumstances of such changes of stock ownership shall be submitted to the Commissioner.

Ordinarily in such cases, where only two corporations are involved, the parent or principal corporation, under the conditions described in (a) above, should file a consolidated return including the income of such subsidiary or subordinate corporation to the date of the change of stock ownership, and each should file a separate return from the date of such change in stock ownership to the end of the taxable period, and, under the conditions described in (b) above, each corporation should file a separate return from the beginning of the taxable period to the date of the change in stock ownership, and a consolidated return should be filed by the parent or principal corporation from the date of change of stock ownership to the end of the taxable year, including therein the income of the subsidiary or subordinate corporation for such period.

Where there are more than two corporations affiliated at the beginning of the taxable year, and due to a change in stock ownership the affiliated status of one or more is terminated, but there remain at least two corporations affiliated during the entire year, the parent or principal corporation should file a consolidated return for the entire year, excluding from its return the income of the corporations whose affiliated status is terminated from the date of the change in stock ownership; or where two or more corporations are affiliated at the beginning of the taxable year,

and through change in stock ownership additional corporations become affiliated, the parent or principal corporation should file a consolidated return and include the income of such corporations from the date of change of stock ownership. In either case, the subsidiary or subordinate corporation whose status is changed during the taxable year should make a separate return for that part of the taxable year during which it was outside of the affiliated group.

Where, in accordance with the procedure set forth above, a return is made by a corporation for a period less than a year, the tax shall be computed in accordance with sections 226 and 239 and the articles thereunder. Where corporations become affiliated during the taxable year the separate returns of the corporations for the portion of the taxable year during which they were not affiliated will not be due until the fifteenth day of the third month following the close of the taxable year. For example, if two corporations become affiliated on July 1, 1926, and elect to file a consolidated return for the period from July 1 to December 31, 1926, the separate returns of the corporations covering the period from January 1 to June 30, 1926, will be due on March 15, 1927. In any case in which the change of affiliated status is for a period so short as to be negligible, a consolidated return or separate returns for the entire period, as the case may be, may be filed; in such cases, however, there should accompany the return a complete statement setting forth the changes in the affiliated status occurring during the taxable year.

Article 651.

Time and place for filing returns. Returns of income must be made on or before the fifteenth day of the third month following the close of the fiscal or calendar year, as provided in section 227 and articles 441-447. In the case of foreign corporations not having any office or place of business in the

United States, however, returns shall be made on or before the fifteenth day of the sixth month following the close of the fiscal year, or, if the return is made on the basis of the calendar year, on or before June 15. A corporation going into liquidation during any taxable year may upon the completion of such liquidation prepare a return covering its income for the fractional part of the year during which it was engaged in business and may immediately file such return with the collector. A corporation having an office or agency in the United States must make its return to the collector of the district in which is located its principal office or agency. Other corporations must make their returns to the collector at Baltimore.

REVENUE ACT OF 1928, C. 852, 45 STAT. 795.

Section 47.

(a) *Returns for Short Period Resulting from Change of Accounting Period.* If a taxpayer, with the approval of the Commissioner, changes the basis of computing net income from fiscal year to calendar year a separate return shall be made for the period between the close of the last fiscal year for which return was made and the following December 31. If the change is from calendar year to fiscal year, a separate return shall be made for the period between the close of the last calendar year for which return was made and the date designated as the close of the fiscal year. If the change is from one fiscal year to another fiscal year a separate return shall be made for the period between the close of the former fiscal year and the date designated as the close of the new fiscal year. (26 U.S.C.A. section 2047 (a).)

Section 47.

(b) *Income Computed on Basis of Short Period.* Where a separate return is made under subsection (a) on account

of a change in the accounting period, and in all other cases where a separate return is required or permitted, by regulations prescribed by the Commissioner with the approval of the Secretary, to be made for a fractional part of a year, then the income shall be computed on the basis of the period for which separate return is made. (26 U.S.C.A. section 2047 (b).)

Section 47.

(c) *Income Placed on Annual Basis.* If a separate return is made under subsection (a) on account of a change in the accounting period, the net income, computed on the basis of the period for which separate return is made, shall be placed on an annual basis by multiplying the amount thereof by twelve and dividing by the number of months included in the period for which the separate return is made. The tax shall be such part of the tax computed on such annual basis as the number of months in such period is of twelve months. (26 U.S.C.A. section 2047 (c).)

Section 117.

(b) *Net Loss as a Deduction.* If, for any taxable year, it appears upon the production of evidence satisfactory to the Commissioner that any taxpayer has sustained a net loss, the amount thereof shall be allowed as a deduction in computing the net income of the taxpayer for the succeeding taxable year (hereinafter in this section called "second year"), and if such net loss is in excess of such net income (computed without such deduction), the amount of such excess shall be allowed as a deduction in computing the net income for the next succeeding taxable year (hereinafter in this section called "third year"); the deduction in all cases to be made under regulations prescribed by the Commissioner with the approval of the Secretary. (26 U.S.C.A. section 2117 (b).)

Section 141.

(a) *Privilege to File Consolidated Returns.* An affiliated group of corporations shall, subject to the provisions of this section, have the privilege of making a consolidated return for the taxable year 1929 or any subsequent taxable year, in lieu of separate returns. The making of a consolidated return shall be upon the condition that all the corporations which have been members of the affiliated group at any time during the taxable year for which the return is made consent to all the regulations under subsection (b) prescribed prior to the making of such return; and the making of a consolidated return shall be considered as such consent. In the case of a corporation which is a member of the affiliated group for a fractional part of the year the consolidated return shall include the income of such corporation for such part of the year as it is a member of the affiliated group. (26 U.S.C.A. section 2141 (a).)

Section 141.

(b) *Regulations.* The Commissioner, with the approval of the Secretary, shall prescribe such regulations as he may deem necessary in order that the tax liability of an affiliated group of corporations making a consolidated return and of each corporation in the group, both during and after the period of affiliation, may be determined, computed, assessed, collected, and adjusted in such manner as clearly to reflect the income and to prevent avoidance of tax liability. (26 U.S.C.A. section 2141 (b).)

REGULATIONS 74, PROMULGATED UNDER THE REVENUE ACT OF 1928.

Article 371.

Returns for periods of less than 12 months. No return can be made for a period of more than 12 months. A separate return for a fractional part of a year is therefore required wherever there is a change, with the approval of the Commissioner, in the basis of computing net income from one taxable year to another taxable year. The periods to be covered by such separate returns in the several cases are stated in the Act. The requirements with respect to the filing of a separate return and the payment of tax for a part of a year are the same as for the filing of a return and the payment of tax for a full taxable year closing at the same time. (See sections 53 and 56 and articles 401-404, 431 and 746.) The tax on net income computed on the basis of the period for which a separate return is made shall be paid thereon at the rate for the calendar year in which such period is included. Where a return is made for a fractional part of a year, except where a return is made for a period of less than 12 months by reason of a change in accounting period, the personal exemption and credit for dependents, and the credit of $3000 allowed a domestic corporation having a net income not exceeding $25,000, shall be reduced to that proportion of the full credit which the number of months in the period for which the return is made bears to 12 months.

In case of a change in accounting period the net income computed on the return for the fractional part of a year shall be placed on an annual basis and the tax computed as provided in section 47 (c). Where the net income of a corporation is placed on an annual basis, the amount of the net income after being placed on such basis determines whether the credit of $3000 is allowable.

REGULATIONS 75

RELATING TO CONSOLIDATED RETURNS OF AFFILIATED CORPORATIONS PRESCRIBED UNDER SECTION 141 (B) OF THE REVENUE ACT OF 1928.

(Applicable to the taxable year 1929 and subsequent taxable years.)

Section 41.

(d) *Taxable Year.* Any period of less than 12 months for which either a separate return or a consolidated return is filed, under the provisions of article 13, shall be considered as a taxable year.

APPENDIX B.

CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

ARNOLD CONSTABLE CORPORATION,
Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

On Petition for Review of Decision of the United States Board of Tax Appeals.

(Decided March 12, 1934.)

Before L. Hand, Swan, and Augustus N. Hand, Circuit Judges.

AUGUSTUS N. HAND, Circuit Judge: This petition for review involves a deficiency of $36,584.54 in the income taxes of Arnold Constable Corporation, a Delaware company. The taxes in controversy are for the fiscal year of that company from February 1, 1927, to January 31, 1928. The deficiency resulted from the holding of the Commissioner that no part of the loss suffered in the fiscal year ended January

31, 1926, by petitioner's affiliate Arnold Constable & Co., Inc., could be allowed in computing consolidated net income for the year ended January 31, 1928. We think that the assessment of a deficiency by the Commissioner was erroneous and the order of the Board of Tax Appeals affirming it should be reversed.

For the fiscal years ended January 31, 1925, and January 31, 1926, Arnold Constable & Co., Inc., sustained net losses of $308,216.45 and $342,461.23, respectively. For the period February 1, 1926, to May 6, 1926, inclusive, it had a net income of $70,730.56, and for that period filed a separate return. On May 7, 1926, approximately 98% of its capital stock was acquired by the petitioner Arnold Constable Corporation, the parent of an affiliated group, and in the consolidated return of the affiliated group the net income of Arnold Constable & Co., Inc., for the period May 7, 1926, to January 31, 1927, was included. During this last period Arnold Constable & Co., Inc., had a net income of $185,677.85. For the fiscal year ended January 31, 1928, petitioner filed a consolidated return showing a net income to Arnold Constable & Co., Inc., of $618,646.68, and claimed an offset to such income of a portion of the net loss sustained by such company during the fiscal year ended January 31, 1926. The Commissioner disallowed the offset and determined a deficiency accordingly. The Board of Tax Appeals affirmed the ruling of the Commissioner and held that the period February 1 to May 6, 1926, for which Arnold Constable & Co., Inc., had filed a separate return and the period May 7, 1926, to January 31, 1927, for which its income was included in the consolidated return constituted two taxable years and that, therefore, the net loss could not be carried past the second taxable year ended January 31, 1927.

The taxpayer contends that the fiscal years from February 1, 1926, to and including January 31, 1927, and from February 1, 1927, to and including January 31, 1928, were each taxable years within the meaning of the applicable provisions of the Revenue Acts of 1926 and 1928, so that the net losses of Arnold Constable & Co., Inc., for both the fiscal years which ended January 31, 1925, and January 31, 1926, should be carried forward and allowed as deductions from the net income for the year ended January 31, 1927 and the net income for the year ended January 31, 1928. The right to do this depends upon the proper interpretation of Section 206 (a) and (b) and Section 226 (b) and Section 240 (a) of the Revenue Act of 1926, taken in connection with Section 200 (a) thereof and corresponding provisions of the Revenue Act of 1928.

Section 200 (a) provides that:

> The term "taxable year" means the calendar year, or the fiscal year ending during such calendar year, upon the basis of which the net income is computed under section 212 or 232. The term "fiscal year" means an accounting period of twelve months ending on the last day of any month other than December. The term "taxable year" includes, in the case of a return made for a fractional part of a year under the provisions of this title or under regulations prescribed by the Commissioner with the approval of the Secretary, the period for which such return is made. The first taxable year, to be called the taxable year 1925, shall be the calendar year 1925 or any fiscal year ending during the calendar year 1925.

Section 206 (b) provides:

> If, for any taxable year, it appears upon the production of evidence satisfactory to the Commissioner that

any taxpayer has sustained a net loss, the amount thereof shall be allowed as a deduction in computing the net income of the taxpayer for the succeeding taxable year (hereinafter in this section called "second year"), and if such net loss is in excess of such net income (computed without such deduction), the amount of such excess shall be allowed as a deduction in computing the net income for the next succeeding taxable year (hereinafter in this section called "third year"); the deduction in all cases to be made under regulations prescribed by the Commissioner with the approval of the Secretary.

It is argued that the words in Section 200 (a): "The term 'taxable year' includes, in the case of a return made for a fractional part of a year * * * the period for which such return is made," are a definition of a taxable year for all purposes. But the words first appeared in Section 200 (a) of the Act of 1924, and were inserted in the corresponding sections of the Acts of 1918 and 1921 to broaden relief which had before that time been allowed to taxpayers.

Under the earlier Revenue Acts the Commissioner of Internal Revenue had ruled that a taxpayer that had been required to make a return for an accounting period of less than twelve months could not carry forward losses sustained in such fractional period and deduct them from a subsequent full year's income or carry forward losses from a full year's income and deduct them from a subsequent fractional period. While the 1924 Act was under consideration A. W. Gregg, Special Assistant to the Secretary of the Treasury, explained to the Ways and Means Committee the situation as it then existed as follows:

In subdivision (a) of this section the term "taxable year" is defined to include a period of less than a year

> when a return is made for such period. Under the existing law the use of the term "taxable year" in the "net loss" section and other sections has been construed not to cover the case of a return made by a taxpayer for a fractional part of a year, with the result that the benefits of such sections are denied the taxpayers who are required by law to make a return for a fractional part of a year.

The revised definition of "taxable year" inserted in Section 200 (a) by the 1924 Act was particularly intended to cover cases where a corporation had begun business within a regular taxable year or had discontinued business, or changed its accounting period before the end of its taxable year. Any interpretation of Section 200 (a) which would make a report for a fractional part of a year prior to affiliation a taxable year for the purpose of deducting net losses under Section 206 (b) deprives corporations affiliating at times other than the beginning of a full taxable year of the right to carry forward net losses over two periods of twelve months each. Should there be affiliations with a number of corporations at different dates in the same year (a not unusual case) the taxpayer might essentially lose the right to deduct the prior year's loss from profits accruing during a period of more than a few days. Such a result is certainly repugnant to the purpose of the statute modeled in general on the English Act and intended in a measure to stabilize income taxes for periods of three full years.

The Supreme Court has construed the income tax acts as in general establishing an accounting period of twelve months. *Burnet v. Sanford & Brooks Co.*, 282 U. S. 359, 363; *Woolford Realty Co. v. Rose*, 286 U. S. 319, 328. The Circuit Court of Appeals of the First Circuit held in *Morgan's, Inc., v. Commissioner of Internal Revenue*, 68 Fed. (2) 325, that a fractional part of the year 1925 for which a corpora-

tion made a separate return was not a "taxable year" in any sense which prevented the corporation when making a consolidated return with an affiliate for the balance of the year 1925 from deducting losses realized in the first part of 1925 from its 1927 income. The Court of Claims expressed a similar view in *Beneficial Loan Society of Bethlehem v. United States*, 48 Fed. (2d) 686, 687. The affiliated taxpayers did not become a single taxable unit but only a single tax computing unit. *Woolford Realty Co. v. Rose, supra.* The return by Arnold Constable & Co., Inc., for a fractional part of the year 1926 was not, in our opinion, a return for a taxable year within the meaning of Section 206 (b) of the Act of 1926, or Section 117 (e) of the Act of 1928, and the losses of Arnold Constable & Co., Inc., sustained for the fiscal years ended January 31, 1925 and January 31, 1926, might be carried forward for the two fiscal years of twelve months each that succeeded the year of such loss. If this had been done there would have been no deficiency in the income tax of the petitioner for the fiscal year ended January 31, 1928.

The order of the Board of Tax Appeals is reversed.